ONTARIO FISCAL OUTLOOK

MEETING THE CHALLENGES

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Treasurer of Ontario
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I. INTRODUCTION

The Ontario Government is embarking on one of the basic exercises that every government faces—drawing up the annual Budget.

In preparing a budget, the government decides how it will collect its revenues and manage its expenditures over the next twelve months. It must make those decisions in a way that best meets the province's economic and social needs.

As the Government begins to prepare the Budget for 1992-93, it is faced with some of the toughest choices that the Province has ever had to make, because of the economic situation.

But if we face this challenge together, we can come through the present difficult times with a renewed economy, a stronger future and a better Ontario for every citizen.

Opening Up the Budget Process

Drawing up a budget has often been considered a specialized process, best left to a small group of government experts. This Government does not share that view. The Budget is more than a financial exercise. It is a practical statement of the government's economic and social priorities. For the forthcoming Budget, we will have to make decisions with great consequences for Ontario—what programs to fund, what reallocations and reductions to make in spending, and what taxes to raise.

Traditionally, governments in Canada have developed the budget in secrecy, to prevent individuals from profiting from advance knowledge of new tax measures. Over the years, governments have expanded budget secrecy to the point that it now routinely prevents disclosure of any information prior to a new budget.

This traditional approach doesn't allow the public to learn what choices the government faces in drawing up a budget, nor does it allow Ontarians to take part in informed pre-budget discussions on how public finances should be managed. It prevents the informed open debate that should be a cornerstone of democracy.

The 1991 Ontario Budget promised to introduce major changes that would open up the budget-making process. With the release of this fiscal outlook, we are bringing budget-making into the 1990s.

The Ontario Fiscal Outlook makes fully public the financial information known to us as we prepare the 1992 Budget. No federal or provincial government in Canada has published such a full accounting prior to budget day. A companion document—the Ontario Economic Outlook, which provides a full report on the economic situation facing Ontario this year—was published in December and is available through the Ministry of Treasury and Economics.

Budgeting in Today's Economy

Drawing up a provincial budget is a critical process at any time, but the present economic realities in Ontario create a unique situation. Ontario is facing its toughest economic challenge since the 1930s. A fundamental restructuring of the global economy, an over-valued dollar, free trade, the restrictive fiscal and monetary policies of the federal government and a persistently deep recession have combined to flatten our economy. People in every part of Ontario are suffering.

The challenge is formidable—to develop the policies that will build a basis for creating new jobs and rejuvenating the economy, and to do so within the framework of today's realities of limited revenues and increasing expenditures.

Almost the first news this Government heard after its election in September 1990 was that there was to be an unforeseen drop in Provincial revenues. Instead of finding a balanced budget as proclaimed by the previous government prior to the election, the new Government found a substantial deficit for 1991.

In drawing up its first Budget last year, the Government was faced with deciding what road to take in dealing with declining revenues and increasing spending demands caused by the combined effects of the recession, economic restructuring and reductions in federal transfers. A restrictive fiscal policy would have resulted in even greater job loss, more economic dislocation and erosion of the public services Ontario needed to get through the recession.

The alternative—the one the Government chose—was to incur a large deficit. Social justice was not the only justification for the road we took. The recession has made less money available for loans, investment and consumer spending. Everyone has suffered to some degree from the depressed economy. It was not the time for one of the major forces in our economy—the government—to reduce its role.

The Province could not turn the recession around on its own, especially with the federal government taking the opposite approach. A provincial government—which does not control monetary or trade policy nor overall national fiscal policies—is limited in what it can do to address the economic downturn.

Nevertheless, we saw the need to create and maintain jobs and to lay the groundwork for a renewed and stronger economy. And we addressed that need. We invested in capital works that preserved public assets and jobs. Despite dropping revenues, we made it a priority to meet the needs of the municipalities, universities, colleges, schools and hospitals.

Time has shown this was the appropriate course of action. Our argument—that government has a role to play in battling the recession—is proving to have been right. Faced with a continuing recession, other governments in both the United States and Canada are now accepting the need for government action to address the economy.

Therefore, the principles that shaped the last Budget—fighting the recession, promoting economic renewal and preserving the quality of life in our communities through social justice and good public services—will shape the Budget for 1992-93 as well. Ontario must create

and maintain jobs, attract dynamic new investment and promote consumer and business confidence.

But circumstances have changed since the last Budget. The recession is broader and deeper than anticipated. Confidence has eroded. The effects of restructuring on Ontario's economy are even more substantial than we imagined they would be in 1991. While maintaining the same goals and values in the 1992 Budget, Government must also recognize and respond to these changing circumstances.

At the same time, we are committed to being fiscally responsible, and we are striving to reduce the government's operating deficit through vigorous efforts to control the growth in our expenditures.

Ontario's Economic Situation

Economic forecasters predict that the Ontario economy will resume growing in 1992. But it will do so very slowly at best, especially compared to the boom recovery of 1983-86 when real economic growth averaged over six per cent per year. During 1992, the economy's total output is forecast to grow by about two per cent, and employment is expected to rise by 59,000 jobs. While we welcome this growth, these figures are well below those published in the Ontario Economic Outlook late last year. They will replace barely one-third of the jobs lost in 1991. This underlines the message that the economy remains in serious trouble. Economic renewal that creates and maintains jobs in the future is vital to our province.

Our economy is closely linked to the fortunes of the United States economy, which is facing the same difficulties that Canada and the rest of the world must confront. Forecasters have lowered their expectations for the Canadian economy this year because of the unexpected weakness in the United States economy.

The forecast for modest growth in 1992 is based on reasonable assumptions, but nobody has an exact method for predicting when a recession will end. If the turnaround in the Ontario economy is delayed longer than we expect, then the hardships facing people and the financial situation for 1992 will become even more difficult.

For the medium-term through to 1995, output is expected to rise by an average of about four per cent a year. The unemployment rate is expected to decline, but is forecast not to fall below eight per cent during this period.

Forecast for the Ontario Economy, 1991-95
(Per Cent)

	1991	1992	1993	1994	1995
Real Growth	-2.4	2.2	4.8	3.8	3.6
CPI Inflation	4.7	2.3	2.6	2.8	2.6
Employment (000s)	-167	59	165	135	138
Unemployment Rate	9.6	9.6	9.0	8.6	8.1

Source: Ontario Ministry of Treasury and Economics.

We want the economy to grow faster than this forecast. We believe that by following the road set out in the 1991 Budget, we can help revive the economy, increase investment and put people back to work.

Ontario's Financial Situation

Throughout the 1980s, Ontario's revenues increased steadily due to a strong economy and increased taxes. Now the economy is in a recession, our revenues have dropped, while demands on public services are reaching unprecedented levels.

The budget deficit—the gap between revenues and expenditures—became the focus of everyone's concern last year. In looking at how we are going to manage the economy, we have to understand the nature of the deficit better.

There are two kinds of spending in government—**capital investment** and **operating expenditures**. Most jurisdictions in North America separate operating and capital costs, treating capital spending as an investment.

In 1991-92, Ontario is spending $3.9 billion on capital investment—building schools and hospitals, roads and transit systems and other projects that create lasting assets. This money represents about two-fifths of this year's $9.7 billion deficit.

It makes good sense to undertake these projects during a recession. Doing so puts people to work who would otherwise be unemployed and creates assets that benefit the economy for years to come. Moreover, these projects would have to be undertaken sometime in the future in any event and building now is much less expensive than building during a boom period. In borrowing dollars for capital investment, we are not burdening our children—we are creating something that they will use and we may also be saving them higher costs in the future.

The other three-fifths of the deficit—$5.8 billion—is accounted for by operating expenditures. Operating costs keep us going on a day-to-day basis, maintaining our public services and the quality of life we derive from them.

It is when operating expenditures get beyond our ability to pay—when the 'operating deficit' becomes large and prolonged—that we must take heed.

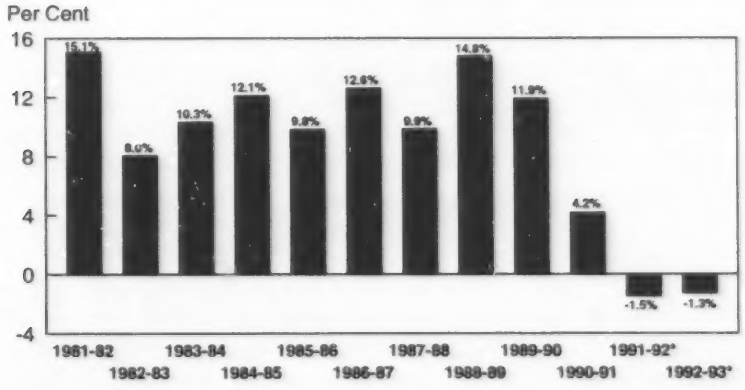
Some of our current operating deficit is due to the temporary downturn in the economy. To the extent that this is so, it would be an over-reaction for us to respond by cutting back needed public services or by raising taxes. The temporary downturn will eventually be corrected and this portion of the operating deficit will disappear. Over-reacting to this cyclical operating deficit would only cause the recession to deepen.

The balance of the operating deficit is not caused by the recession. Spending on some programs has been growing steadily and in excess of the rate of inflation for a number of years. This is the type of spending we must examine and address. Doing so is all the more necessary since the expenditures related to the recession are not likely to diminish in the short-term.

Expenditures are only one side of the picture, however. Revenues are what make expenditures possible and it is on this front that we have been hit hardest.

Our projections are that, for the second year in a row, the government's revenues will not increase in 1992. This situation is unprecedented. The last time government revenues actually dropped from the preceding year was in 1945. Yet revenues declined in 1991, and—based on our current projections—they will drop again in 1992.

Growth in Ontario's Revenues
1981-82 to 1992-93



* Estimate.

For much of the 1980s, Ontario's revenues grew by ten per cent per year or more. Some of this expansion was attributable to the strong growth in the province's economy, which averaged over six per cent in the years 1983 to 1989.

However, a large share of the revenue boom of the 1980s was due to tax increases. Almost one-quarter of the increase in the Province's revenues between 1985 and 1991 came from raising taxes. Without those increases, the government of the day would have had a substantial deficit in 1989 rather than a small surplus.

So without major tax increases almost every year, the Province's finances would have been in difficulty even at the height of the boom.

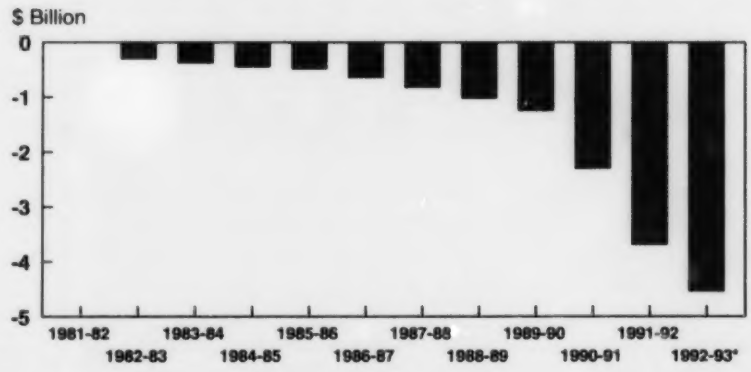
Now—even with the tax increases of the mid-1980s still in place—we face two years in a row of declining revenues.

The weak economy is partly to blame. The modest recovery that we hoped would begin in late 1991 has been delayed, not least by the unexpected weakness in the United States economy, which is so important to our exporters. With so many out of work, fewer people have been paying Personal Income Tax (PIT). Families are spending less, which depresses revenues from the Retail Sales Tax (RST) and other consumption taxes. Less money is coming in from corporate taxes because business profits, as a share of total economic output, are at their lowest since the 1930s.

The federal government's policies have made things even worse. The Goods and Services Tax (GST) has undermined consumer confidence and hurt business. The Free Trade Agreement, implemented with no transitional adjustment programs and with a highly over-valued Canadian dollar, has cost us jobs and investment.

The federal government has shifted massive amounts of its debt to the provinces by cutting back on payments for health care, education and social assistance. These cuts are costing Ontario $3.7 billion in 1991-92, an amount equal to more than one-third of the Province's deficit. In the coming year, we expect the shortfall in payments from Ottawa to grow to $4.5 billion.

Ontario Revenue Losses Due to Federal Reductions In EPF Payments and CAP Entitlements since 1982



* Projected
Note: Cumulative Losses 82-83 to 92-93: $15.8 billion

The moderate pace of economic growth we are expecting in 1992 has significant implications for the province's finances and for the quality of life of its citizens. Half a million Ontario

workers are unemployed. Many are in need of training and help in finding new jobs. Without adequate assistance, there is a risk that many workers will lose their skills if they aren't able to find work in a reasonable period of time. This would be a major impediment to Ontario's continued prosperity in the long run.

Adding to these difficulties are the federal government's tighter restrictions on Unemployment Insurance (UI), so that fewer unemployed workers qualify for benefits, and those who do qualify are cut off from benefits sooner. It is expected that about 400,000 workers will exhaust their UI benefits this year. One million Ontario residents are relying on social assistance—including one child out of every six. We need to have economic and budgetary policies that help fix these problems, rather than make them worse.

Moderate economic growth is not likely to create an immediate or dramatic improvement in the Province's revenues. Revenues from sales tax and personal income tax are heavily dependent on lower unemployment and an improvement in consumer confidence. Revenues from corporate taxes will not improve until more companies regain their profitability. The federal government has so far shown little interest in re-thinking its cutbacks on transfers for health, colleges, universities and social programs.

So even if the economy rebounds more strongly than we expect, the deficit would not immediately decrease substantially. As a rough rule of thumb, an increase of one percentage point in economic growth will increase the Province's revenues by $350 million. The economy would need to grow at an unprecedented rate—while holding all expenditures constant—in order to eliminate this year's operating deficit.

In sum, we need to prepare the way for stronger economic growth in this Budget to provide the wealth that will help us reduce the deficit. But economic growth by itself will not solve all the financial challenges we face. We must also work together to control operating expenditures while maintaining and improving public services.

Meeting the Challenges

Over the decades, we have developed public services based on an economy that provided rapidly increasing government revenues and a continually improving standard of living. Within a brief period, a brake has been applied, and the shift it has imposed on economies around the world is profound.

In a number of cases—but particularly in the 'big-ticket' items of health care, social services and education—operating costs have been climbing steadily, and have been allowed to go up at rates in excess of inflation. We paid for those increases in the 1980s with growth and higher taxes. The money has stopped coming in, but the spending demands and the habits of the 1980s are still with us. We have to redirect our investment to economic renewal, and we have to make sure the public sector matches what we can afford.

The solution is not to chop spending irrationally and at the expense of all other priorities. We can use this period to re-think what kinds of services we want our tax dollars to provide

for us, and how we can make sure those services are delivered as efficiently and effectively as possible.

For example, the Government and the Ontario Medical Association have already applied this approach to the health care system in a landmark agreement to introduce a management system that emphasizes quality and cost-effectiveness. The agreement contains ways of identifying and limiting spending on services that are not essential, without limiting access to health care.

In the same vein, a general review of government spending is underway. The Government has already taken steps to control its spending on consulting and professional services. Other costs are being reviewed, such as communications and advertising, the Ontario Drug Benefit Program (ODB), the Ontario Legal Aid Plan (OLAP) and government spending on commercial health laboratories. A full list of policies and programs under review appears in the Appendix.

We expect to be able to take positive steps in the administration of other public services as well. Not only will they help us to control expenditures during this period, but designing a network of affordable services will be a legacy to future generations in Ontario.

Our plans are to continue with the principles that shaped the last Budget—fighting the recession, promoting economic renewal and preserving the quality of life in our communities through social justice and good public services.

Our economic and financial situation demands that the Government continue to take a leadership role. We need to do more to pave the way for a stronger economy that will create the basis for a prosperous future. Public services have to be preserved while we make sure that tax dollars are spent efficiently.

We're sharing an unprecedented amount of information prior to drawing up a budget because we believe you have a right to it. Easy answers and simplistic solutions just won't do, and to pretend otherwise isn't doing the taxpayers any favour. And that's why we have to change the way we make decisions in this province. Ontarians have a right to be involved. We think the budget-making process is a good starting point.

Everyone—those who design the services, those who deliver them, those who use them, those who pay for them—should take this opportunity to make their views known. Through your MPP, community groups, unions, service clubs, professional associations, the media or directly to the Treasurer by writing with your advice—you should be heard.

II. Fiscal Outlook for 1992-93

This section starts with an overview of Provincial revenues and expenditures for the fiscal year 1992-93, which begins April 1, 1992. It provides the reader with a sense of what would happen with Ontario's finances under a 'no-change' set of assumptions. That is, if next year's Budget was drawn up to include all of the programs instituted to date, but no others, this is what the Budget would look like. **This 'no-change' scenario for 1992-93 is not acceptable to the Government. However, it serves as a starting point and allows everyone to see why some tough decisions are needed relating to revenues, expenses and the deficit.**

'No-change' Outlook

In the 'no-change' outlook, no additional tax increases or decreases were assumed. The latest available information for 1992-93 spending was incorporated assuming no further changes to programs, policies or service levels. All recent major Government decisions on expenditures have been incorporated including:

- the decision to increase social assistance rates by two per cent effective January 1, 1992;
- the decision that grants to the major transfer recipients (hospitals, school boards, universities, colleges and municipalities) for 1992-93 will be held to a one per cent increase, with an additional sum of $160 million to assist them to undertake reform and restructuring measures;
- the October 1991 decisions to freeze the salaries of MPPs for 1991 and 1992 and senior managers for 1992 and to implement a 10 per cent reduction in the non-salary budgets of government ministries; and
- the December 18th announcement to assist low-income women to achieve pay equity. This is a priority commitment of the Government to ensure fairness for an additional 420,000 women.

As discussed in the introductory chapter, government spending on capital investment is separated from ongoing operating expenses.

The 1991 Budget provided a Medium-Term Fiscal Outlook which projected that revenues would increase to $47.2 billion and operating expenditures to $51.7 billion in 1992-93. This projection was based on an economic outlook which saw the economy beginning to recover in the second half of 1991.

The current outlook for 1992-93 forecasts a much slower economic recovery than was anticipated. Based on our 'no-change' outlook, operating expenditures would be $53.4 billion—up $1.7 billion from the numbers we published last spring. This spending increase is largely caused by higher-than-anticipated social assistance caseloads and higher Public Debt Interest (PDI) charges.

More significantly, the 'no-change' scenario shows revenues declining for a second straight year to $42.2 billion. This is $5 billion less than anticipated last spring. Although slightly over $1 billion of this shortfall is due to tax increases that had been planned for 1992-93, the balance of the decline—nearly $4 billion—is a result of continued weakness in the economy.

In summation, the operating deficit under the 'no-change' scenario—which is absolutely unacceptable to the Government—would be $11.2 billion in 1992-93, as compared to a projected $5.8 billion for 1991-92. If regular capital investment at last year's level is added to this figure, then our new financing requirements for capital and operations for 1992-93 would be an unacceptable $14.3 billion. To calculate this figure, one would add the operating deficit and capital investment, and subtract the $200 million in amortization that is built into the 'no-change' operating expenditure budget. The amortization figure is explained later in this chapter.

The Operating Deficit Outlook
($ Billions)

		1992-93		
	1991-92 Revised	As Planned in 1991 Budget (April 1991)	'No-Change' Outlook (Jan 1992)	Difference
Revenue	42.8	47.2	42.2	-5.0
Operating Expenditure	48.6	51.7	53.4	+1.7
Operating Deficit	(5.8)	(4.5)	(11.2)	-6.7

While recognizing the significant and unexpected erosion of our revenue base, the Government is still striving to reduce the deficit in 1992-93 from its 1991-92 level. The Government is aware that this will mean taking some very difficult decisions.

Revenue Outlook for 1992-93

After growing more than ten per cent per year since 1981-82, government revenues are actually expected to drop by 1.5 per cent in 1991-92 to $42.8 billion. Under the 'no-change' assumptions outlined above, revenues would decline again in 1992-93 to $42.2 billion.

This revenue forecast for the coming year assumes that revenues for 1991-92 will hold at the expected level of $42.8 billion. There is still some uncertainty in the 1991-92 forecast because of a number of figures which will not be known until February or March, including the size of retail sales tax revenues over the critical Christmas season, final tax payments by corporations in February and March 1992, and any further adjustment to personal income tax revenues when final 1990 data become available in February. Revisions to the 1991-92 outlook due to those factors could also change the 1992-93 outlook.

Revenue growth in 1992-93 will be directly linked to the strength of the economy. Historically, revenues have grown at an average of 90 per cent of the rate of growth in the economy (as measured by the dollar value of Ontario's Gross Domestic Product). In periods of recession, this relationship weakens and revenue growth falls below this historic average. As the economy moves out of a recession, revenue growth is slow to recover.

The major sources of tax revenue—personal income tax, corporations tax and retail sales tax—have the longest recovery times after a recession because of their tax and payment structures. For example, corporations will be able to reduce their taxes even during periods of rising profits because they can write off their losses from previous years.

So while the economy is expected to grow and slowly move out of the recession in 1992, revenues will decline again due to the lags described above and a large decline in personal income tax, the Province's largest single revenue source.

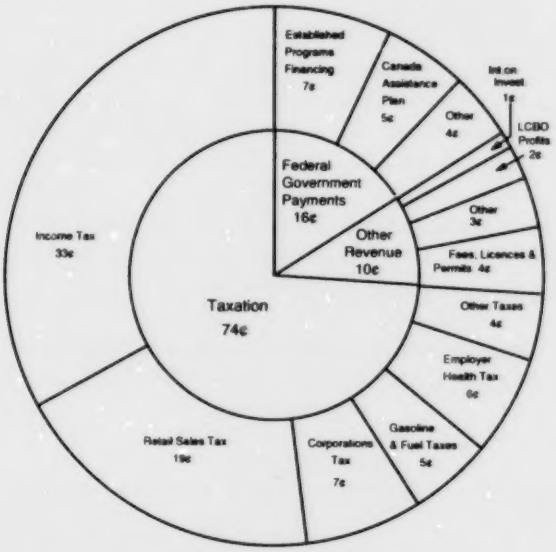
About 74 per cent of Ontario's revenues comes from taxes, 16 per cent comes from the federal government, and the balance of ten per cent comes from miscellaneous sources. The following briefly outlines the key assumptions behind the forecast of revenues expected in 1992-93 from the major revenue sources.

Revenue Outlook
($ Millions)

	1991-92 Revised	1992-93 'No-change' Scenario	Difference (%)
Personal Income Tax	14,135	13,170	(6.8)
Retail Sales Tax	7,960	8,110	1.9
Corporations Tax	3,100	3,290	6.1
Gas and Fuel	1,970	2,300	16.8
Employer Health Tax	2,665	2,790	4.7
Other Taxes	1,910	1,860	(2.6)
Federal Government Payments	6,711	6,370	(5.1)
Fees, Licenses and Permits	1,662	1,780	7.1
LCBO Profits	665	610	(8.3)
Other	2,009	1,935	(3.7)
Total	**42,787**	**42,215**	**(1.3)**

Personal income tax, which makes up one-third of Provincial revenues, is projected to decline by almost $1 billion from the 1991-92 level to $13.2 billion. This decline is caused by continuing high unemployment and low personal income growth in Ontario and a $300 million repayment to the federal government for the 1990 tax year. This large decline more than offsets modest growth in most of the other major tax sources.

Composition of Ontario Revenues 1991-1992*



* Forecast as of November 1991.
Source: Ontario Ministry of Treasury and Economics.

Corporations tax revenues are expected to grow by 6.1 per cent to $3.3 billion in 1992-93. However, this improvement is from the very low levels in 1991-92. In 1989-90, corporations tax revenues were $4.7 billion, indicating how much profits have dropped since then. Corporations tax revenues are not expected to return to pre-recession levels until 1994-95.

Retail sales tax revenue will likely grow about 1.9 per cent to $8.1 billion. This outlook assumes individuals and businesses will continue to pay off some of their debts, given the uncertain economy, continuing high unemployment and low consumer confidence.

The Role of Federal Transfer Payments

Federal transfer payments are expected to decrease by approximately $340 million in 1992-93. The 1991-92 levels include the expected $585 million one-time stabilization payment that Ontario has applied for to partially compensate for the decline in Provincial revenue. Federal payments to Ontario for 1992-93 are expected to total $6.4 billion.

Payments from the federal government will account for about one-seventh of Ontario's revenues.

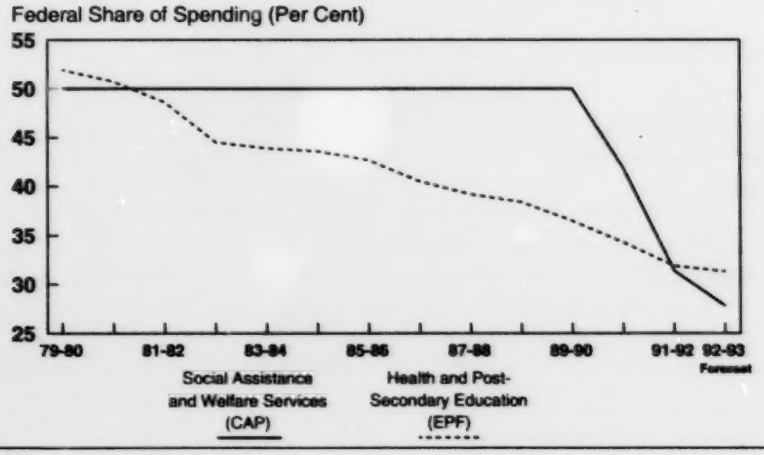
Since the early 1980s, payments under the Established Programs Financing (EPF) transfer, made to assist the provinces with the cost of health care and post-secondary education, have been steadily eroded. The per capita entitlements under the EPF program have been frozen since 1990-91, and will be frozen again in 1992-93.

The increase in federal transfers to Ontario, Alberta and British Columbia under the Canada Assistance Plan (CAP)—a cost-sharing program to support provincial social assistance—has been limited to five per cent. This has denied federal assistance to Ontario during its most serious recession since the Second World War, when unprecedented numbers of Ontarians are relying on their governments for assistance. This is unfair to the citizens of Ontario who have willingly paid their share of federal taxes to support programs in other provinces through good times and bad times.

The consequences of these restrictions have been severe. The federal share of health care and post-secondary education spending in Ontario has been reduced from a high of 52 per cent in 1979-80 to about 31 per cent in 1992-93. The federal contribution to eligible social assistance and related spending has declined from 50 per cent set under the Canada Assistance Plan to less than 28 per cent in 1992-93 for Ontario. If the federal government had honoured the original terms of EPF and CAP, Ontario's deficit in 1991-92 would have been $3.7 billion lower. For 1992-93, the shortfall in federal payments is projected at $4.5 billion.

Despite these very substantial effects, the federal government announced in its 1991 Budget that the limits on EPF and CAP would continue in force until 1994-95.

Federal Support for Social Assistance, Health and Post-Secondary Education in Ontario



Operating Expenditure Outlook for 1992-93

Operating expenditures are an important part of how we sustain our high standard of living. The operating budget maintains literally thousands of critical public services that each of us come into contact with daily, including our transit systems, public hospitals, schools, police, cultural institutions and libraries.

Under a 'no-change' scenario for 1992-93, operating costs alone—exclusive of capital investments—would total $53.4 billion, an increase of 9.9 per cent. Social assistance and public debt interest charges would account for more than half of the increase.

Operating Expenditure Outlook
($ Millions)

	1991-92 Revised Outlook	1992-93 'No-change' Scenario	Difference
Major Transfers	15,946*	16,106	160
Transition Assistance for Major Transfers	0	160	160
Social Assistance	5,150	6,400	1,250
Public Debt Interest	4,960	6,160	1,200
Pay Equity	75	385	310
Ministry of Health (Excluding Hospitals)	9,410	9,680	270
Teachers' Pension Fund	820	1,030	210
Amortization of 1991-92 Capital	0	200	200
Ministry of Community and Social Services** (Excluding Social Assistance)	3,210	3,420	210
Non-Profit Housing	430	620	190
Ontario Legal Aid Plan	165	280	115
All Other	8,429	8,964	535
	48,595	53,405	4,810

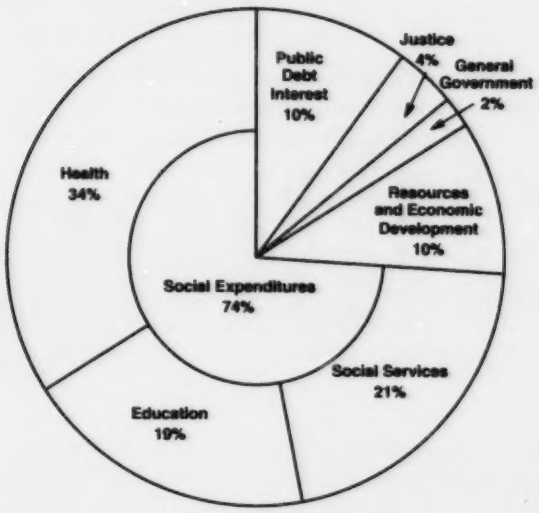
* Includes one-time adjustments.
** Includes Long-Term Care Reform funding.

The only reason that the 1992-93 increase in operating costs would be below ten per cent is that the Government has already made some very difficult decisions which will reduce next year's spending growth. A key decision has been to provide a general increase of only one per cent to the Government's major transfer recipients (hospitals, school boards, universities, colleges and municipalities).

To provide an incentive for change, the Government has announced an additional $160 million to assist with reform and restructuring within these sectors.

The saving from this decision is about $160 million per percentage point. For example, had average increases of five per cent been provided, the Government would have had to spend an additional $640 million.

Composition of Ontario Operating Expenditures
1991-92**



** Forecast as of November 1991.
Source: Ontario Ministry of Treasury and Economics.

There has been a marked change in the distribution of government spending over the past decade. Although health care is still the largest share of the budget, the most significant increase has been in social service expenditures which now account for 21 per cent of the budget, up from 13 per cent ten years ago. While benefits for social assistance recipients have improved, this dramatic increase is largely due to the sharp rise in the number of people who need social assistance and who are eligible for programs such as housing support because of their low incomes.

Over the past ten years, social assistance has grown at an average annual rate of 20.3 per cent. In 1992-93, spending on social assistance is expected to increase by $1.2 billion to a total of $6.4 billion. The number of families and individuals who will have to rely on this program will increase by about 20 per cent. The fastest growing category is that of single employable adults, a direct result of the recession.

The Ontario Legal Aid Plan and non-profit housing programs have also grown substantially in recent years. Legal aid has grown at an average annual rate of 14.9 per cent over the ten year period, mainly as a result of fee increases, the Askov decision to speed-up the consideration of cases in the courts and an increase in the number of people financially eligible for services. This is another program whose growth is at least partly due to the inequities in our society, inequities that are aggravated by the recession. In 1992-93, the legal aid plan is expected to need approximately $115 million more than allowed for in 1991-92, an increase to approximately $280 million.

Subsidies paid for non-profit housing are expected to increase from $33 million in 1987-88 to over $600 million for 1992-93. Programs to construct new housing units that were announced in previous years are now being completed and as people move into these units, subsidy payments are needed.

Health care spending has also risen, from 31 per cent of the budget in 1981-82 to 34 per cent by 1991-92. This trend is largely the result of rapid growth in open-ended programs such as the Ontario Health Insurance Plan (OHIP) and the Ontario Drug Benefit Plan, where the government has an obligation to meet all service demands. Because of actions taken by the Government, the growth in health care operating costs is expected to slow in 1992-93.

One important component of social spending is long-term care. To continue fulfilling the Government's $647 million commitment to the reform of long-term care, an additional $100 million is anticipated to be required in 1992-93. As the number of elderly increases dramatically in the next decades, this reform is vital to providing adequate and affordable services in the future.

In addition, the Government is required to pay $210 million more to address the unfunded liability in teachers' pensions, as provided for in the *Teachers' Pension Act, 1989*.

In 1992-93, public debt interest costs would rise by $1.2 billion to a total of $6.2 billion under the 'no-change' outlook. Total interest payments would be higher because our debt would be higher. The increase takes into account the recent decline in interest rates.

In 1992-93, the Government will spend an additional $310 million to help implement pay equity. These incremental funds will raise total pay equity assistance to $385 million in 1992-93.

Under the new system of accounting for capital investment, a portion of the previous years' capital borrowing must be amortized and charged to the operating budget each year. In 1992-93, this change will add $200 million to operating expenditures.

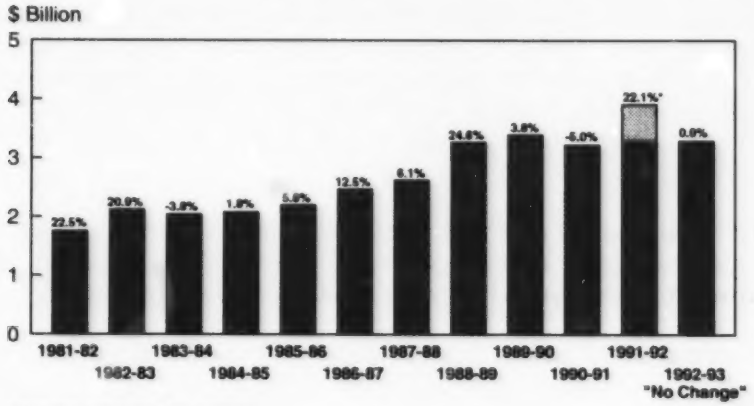
Capital Investment

Capital investment by the Province contributes to the long-term health and development of Ontario's economy. Provincial investment in Ontario's infrastructure acts as a catalyst for economic growth, assists the private sector to remain competitive and provides long-term benefits to the public.

The Provincial Government directly, or indirectly through transfer payments, is providing more than $3.9 billion for capital investments in 1991-92, an increase of more than 22 per cent from the previous year. These capital expenditures are being used to support the purchase or construction of a diverse range of physical assets such as roads, hospitals, buses, water and sewage facilities and educational facilities.

The following chart shows Ontario's capital spending over the past decade.

Capital Expenditures
1981-82 to 1992-93



* Includes anti-recession program.

The 1991-92 revised outlook for capital spending is $3.9 billion. Of that amount, $620 million was for one-time anti-recession capital works. Thus, the 'no-change' allocation for capital spending in 1992-93 would be $3.3 billion.

For 1992-93, there are significant demands to increase capital spending beyond $3.3 billion in order to create jobs, rehabilitate existing infrastructure and add new infrastructure that will help improve Ontario's competitive position and accommodate population growth. While this would have little immediate effect on the operating deficit, it would increase our financing requirements in 1992-93.

Financial Implications of Debt

It is important to put Ontario's debt situation in perspective.

Our economy can readily afford the debt load we have now. Our debt is lower, in comparison to the size of the economy, than that of most other provinces and certainly far lower than the federal government's. Our credit rating remains high. It compares well with

those of other provinces and of most U.S. states including New York and Michigan, our principal trading partners.

But with the structural change in our economy, debt loads can grow quickly. If current spending and revenue trends were to continue unchanged, the Province would have to borrow billions more and would have billions more debt to repay.

What kind of problems does a larger debt load present? The first problem is the interest that must be paid.

Over the longer term, borrowing at high levels means that public debt interest will rise as a share of revenues. If the Province were to continue on the 'no-change' track, PDI would increase from 11.6 per cent of revenues in 1991-92 to about 20 per cent of revenues within four or five years. In other words, 20 cents of every tax dollar would go simply to pay the interest on the public debt. Like the federal government—which now spends about 35 cents out of every tax dollar on debt interest—Ontario would face a debt trap that would greatly reduce our flexibility to address social needs or to deal with economic issues like the recession.

Quite apart from the size of the debt and what it will cost to pay the interest, there are other factors. As the global economy changes, so does the financial environment. How much Ontario can borrow, from whom and on what conditions, are all changing.

When Ontario borrows in the public financial markets, it must compete directly with other borrowers. Many other countries, particularly the United States, are facing the same kind of financial pressures that we are. This is increasing the level of competition for available funds.

Ontario is considered a major borrower by international financial markets. For 1991-92, the Province borrowed about $10 billion ($9.7 billion to fund the deficit and $0.6 billion for debt retirements) on international and domestic markets.

Ontario has been effective so far in borrowing the money it has needed. But as we have to seek out more sources of financing, the cost of borrowing goes up.

The cost of borrowing may also increase if our credit rating goes down. A higher credit rating makes it easier for Ontario to borrow the amounts of money it needs. Many large lenders, like pension funds and life insurance companies, restrict a large part of their lending to only the highest credit ratings. For example, Ontario—with its double A rating—can borrow substantially more from these lenders than a similar borrower with a single A rating.

There are a number of factors affecting the stability of our credit rating— the state of our economy, debt in relation to GDP, public debt interest relative to revenue and, perhaps most important, responsible fiscal management.

Even as the economy improves, growth will only partially address these financial complexities. Borrowing is easiest when investors see higher rewards from buying bonds than from buying other assets such as stocks. This is most likely to be the case when the

economy is in poor health. But as the economy improves, investors begin to turn away from buying bonds and start choosing other investments. Because the Province relies on issuing bonds as a way of raising money, this situation would further diminish the number of choices available to us.

The Province will also have to address the future implications of accumulated debt. This future will include not only public debt interest costs but also higher levels of maturing debt. As bonds come due, the principal must be paid off either with revenue dollars or with refinancing.

For these reasons and others, the Government is committed to ensuring that this 'no-change' scenario for 1992-93 does not come to pass. The challenge facing us is to prepare the way for a stronger economy and to find new ways to deliver public services more affordably.

III. How Government Spends

Since 1985-86, Ontario's spending—on a per capita basis—has grown faster than any other province's. In 1991-92, Ontario's total operating spending grew by 12.4 per cent over the previous year.

The operating expenditure forecast in the 'no-change' outlook is not significantly higher than that in the April 1991, Medium-Term Fiscal Outlook and the depth of the recession is largely to blame where costs are up. Nevertheless, there are several approaches that the Government can use to control the operating deficit on the spending side:

1. It can limit inflationary increases to government ministries and transfer payment agencies (including increases in public sector compensation);

2. It can review existing programs and services to achieve efficiencies and rationalize present expenditures; and

3. It can limit allocations for new programs, called New Initiatives.

The Government will use each of these approaches in its 1992-93 Budget. This section will provide context for the use of each.

1. Inflationary Increases and Public Sector Compensation Levels

Historically, the government increases grants to ministries and transfer agencies to help meet increased costs due to inflation.

The 'no-change' fiscal outlook for 1992-93 reflects the decision that there will be a one per cent increase in these grants for the major transfer recipients.

This will have major implications for the delivery of public services and will require difficult choices. Transitional assistance of $160 million will be available for major transfer recipients in 1992-93 to assist in the reform and restructuring of programs and service delivery. Ministries will be working with their transfer partners, their employees and their trade unions to develop strategies for meeting the challenge.

The Government has also decided to apply the one per cent increase to all transfer agencies. This will save a total of $205 million per percentage point, composed of $160 million for the major transfer recipients and approximately $45 million for all other transfer agencies.

Effect of One Percentage Point of Inflationary Increase	
	$ Million
Municipalities, universities, colleges, schools and hospitals	160
Other transfer payment recipients	45
Total	**205**

There are related but separate rate increases associated with OHIP, the Ontario Drug Benefit Plan and social assistance. Increasing these programs by one percentage point would cost $53 million for OHIP, $10 million for the ODB program and $52 million for social assistance.

About 800,000 Ontarians—one-sixth of the labour force—are employed in the Ontario Public Service (OPS) or in the Broader Public Sector (BPS). Of these, about 700,000 work for municipalities, universities, colleges, school boards, hospitals, and smaller agencies that receive government funding. About 92,000 are directly employed in the Ontario Public Service with most employed in direct service delivery such as courts administration, the Ontario Provincial Police and psychiatric hospitals.

Approximately 48 per cent of government operating spending, more than $23 billion, is for salaries and wages in the OPS and the BPS. The table below indicates the proportion of transfer grants which goes towards salaries:

Salaries As a Share of Operating Expenditures (Per Cent)	
Colleges	80
Universities	80
Hospitals	75
Municipalities	50
School Boards	80
OPS Programs	65

Given that salaries and wages represent such a significant portion of the Budget, wage settlements in these sectors have a substantial impact on Provincial finances. Recently, the Province and the Ontario Public Service Employees Union (OPSEU) reached a tentative settlement which, if ratified, will make significant progress towards maintaining the level of public services in our current fiscal situation.

2. Policy and Program Expenditure Review

The Treasurer announced on October 2, 1991 that the Government has undertaken a major policy and program expenditure review exercise, as an important part of the budget process. "Delivering programs better and cheaper" has become a key theme in this process.

The purpose of these reviews is to take a hard look at the Province's current base expenditures, whether they are achieving their intended objectives and whether funds are being spent efficiently. By cutting out waste and more carefully designing existing programs, the Government will be better able to control the rate that spending grows and allocate funds to Government priorities.

These reviews provide more than just a way to save money—they are also an opportunity to make long-needed reforms and restructuring within the public sector. In many cases, this can result in services which are not only less expensive, but which also better serve the public. For example, in the field of health care, reform may decrease the use of questionable or ineffective services while improving the availability of services vital to preserving health and well being.

A number of reviews are already under way that are looking at:

- Efficiency improvements—for example, streamlining the court system;
- Measures to reduce cost increases in rapidly growing programs such as the Ontario Drug Benefit Plan, legal aid and social assistance; and
- Developing new revenue sources by reviewing non-tax revenue opportunities and maximizing the use of government assets.

A full list of these reviews is contained in the Appendix.

These reviews are often being done in consultation with people within and external to government. These discussions are helping to develop options that will best meet the needs of specific client groups and Ontarians generally.

The Government has decided to make this assessment and re-evaluation of its policies and programs a permanent feature of the budget process. Over time, all programs will be reviewed, as a way of ensuring we continue to get value for our tax dollar, and to give the Government some fiscal flexibility in meeting its priorities.

As the following table shows, ten programs account for approximately two-thirds of Ontario's operating costs. Achieving any significant expenditure savings will require addressing growth in these programs.

Ten Largest Operating Programs

Program	1990-91 Actual	1991-92 Revised Outlook	Per Cent Increase
	($ Millions)		
Operation of Hospitals	6,702	7,285	8.7
Ontario Health Insurance Plan	4,692	5,257	12.0
Social Assistance	3,489	5,150	47.6
Public Debt Interest	4,313	4,960	15.0
Operation of School Boards	4,521	4,839	7.0
Operation of Universities	1,823	1,944	6.6
Operation of Colleges	772	826	7.0
Unconditional Grants (Municipal)	902	947	5.0
Ontario Drug Benefit Plan*	755	831	10.0
GAINS** and Property & Sales Tax Grants	592	603	1.9
Total	**28,561**	**32,642**	**14.3**

* Excluding Ministry of Community and Social Services.
** Guaranteed Annual Income System for seniors.

The balance of the Government's spending provides literally thousands of programs and services. While it is not possible to list them all, the following table provides a small sample and shows their share of Provincial operating spending.

A Sample of Some Smaller Provincially Supported Programs and Services		
Program	**1991-92* ($ Millions)**	**Share of Spending (Per Cent)**
Implementation of Junior Kindergarten and Full Day Senior Kindergarten	54.0	0.111
Trade Expansion Fund - Grants	2.0	0.004
MPPs' Salaries	8.0	0.017
Native Land Claims and Self-Government Negotiation Initiatives	15.0	0.031
Grants Under the Small Business Development Corporations Act	8.6	0.018
Grants for Settlement and Integration of New Immigrants	4.6	0.009
French Language Services Act - Implementation	34.4	0.071
Wife-Assault Programs	70.0	0.144
Anti-Racism Strategy Program	7.2	0.015
Human Rights Commission	12.2	0.025
Municipal Recycling Support Grants	25.0	0.052
TVOntario (Ministry of Culture and Communications)	63.2	0.130
Ontario Advisory Council on Senior Citizens	1.1	0.002
Ontario Place Corporation	3.9	0.008

* Based on 1991-92 Expenditure Estimates.

3. New Initiatives Spending

In each of the last three Provincial Budgets, there was between $500 and $800 million for new programs. In 1991 this money funded new priorities such as pay equity, the Manufacturing Recovery Program and the Employee Wage Protection Program.

In the coming year, funding will be needed to help encourage economic renewal—for restructuring core industries and for other initiatives which advance the goals of creating jobs, improving training and increasing investment.

However, all such investments in economic renewal will add to the 'no-change' operating deficit. We will need to find better ways of limiting inflationary growth in existing programs and redirecting money from low-priority programs in order to have the funding we need for new initiatives.

IV. How the Government Raises Money

There aren't many ways the Provincial Government can increase its revenues without considering raising taxes. This section will look at the present tax system. It will also provide information on what the Government is doing to look at other revenue-raising measures.

Fairness in Taxation

The Government is committed to improving the fairness of the tax system. It is becoming more and more widely accepted that taxation should be progressive, that is, it should acknowledge that some people can afford to pay more than others. A fair tax system ensures that the costs of government services are equitably shared among the people of Ontario, according to their ability to pay.

The 1991 Budget took some initial steps to improve the fairness of the tax system. It gave the biggest break to low-income taxpayers in the history of the Ontario Tax Reduction program, increased the personal income tax surtax on higher-income earners, and increased the capital tax for banks and loan and trust companies. In addition, the Fair Tax Commission (FTC) was established to examine and provide advice on a number of specific tax issues, including a corporate minimum tax and a land speculation tax.

The Government believes a continued emphasis on fairness in the tax system—improving progressivity, evaluating the equity and efficiency of existing tax expenditures and addressing the perception that the tax burden is not shared fairly—is important. The Government is looking forward to advice from the Fair Tax Commission working groups and public consultations on improving the fairness of the current tax system.

Ottawa has not shared this commitment to tax fairness. And this has affected us directly.

Federal tax reform made personal income taxes less progressive. We want to make the Ontario income tax more progressive but are limited in the way we can apply our income tax.

Ontario introduced a payroll tax. The federal response was to announce its intention to limit the deductibility of such taxes.

At a time when the need for social assistance spending has dramatically increased, the federal government has unilaterally abandoned its responsibility to share these costs by limiting its Canada Assistance Plan contributions.

Ontario taxpayers provide some 45 per cent of federal revenues. The federal government's cutbacks in transfer payments to Ontario and the need to improve the fairness of the tax system—all at a time when our responsibilities are greater than ever—mean that the fiscal and tax relationships between Ontario and the federal government require urgent attention.

Estimated Revenue Yields

The table below shows how much specific tax increases will yield. For example, the table shows that increasing the tax on alcohol by ten cents per litre will raise about $105 million over twelve months. If a tax is implemented part-way through the fiscal year, the yield in that year will be lower.

Estimated Yields
($ Million)

	Rate Increase	Full Year Yield[1]
Commodity Taxes		
Gasoline Tax	1 cent/litre	120
Tobacco	1 cent per cigarette	140
Alcohol	10 cents/litre	105
Payroll Tax		
Employer Health Tax	1/10 point	145
Income/Sales Taxes		
Personal Income Tax	1 point	275
Corporate Income Tax	1 point	160
Retail Sales Tax	1 point	900
Capital Tax	1/10 point	140

1. Assumes no change in behaviour, except tobacco.

Taxes and the Economy

In looking at possible increases in taxes, it is important to evaluate their impact on people and the economy in relation to the benefits to provincial revenues.

In recent years, taxes at all levels of government have increased. From 1985 to 1990, federal tax revenue as a per cent of Gross Domestic Product (GDP) has increased by two percentage points to 17.6 per cent. During the same period, Ontario own-source revenue as a per cent of Ontario GDP increased by 1.6 percentage points to 13.4 per cent. At the local government level, actual own-source revenue as a per cent of provincial GDP increased just over half a percentage point to 5.7 per cent in 1990.

The following table shows federal, provincial and local revenue changes as a share of the economy over the past decade:

Taxes and Other Revenue as a Per Cent of Gross Domestic Product (GDP)

	1981	1982	1985	1988	1989	1990	1991*
Total Federal Revenue as Per cent of National GDP	16.5	16.1	15.6	16.3	16.0	17.6	18.5
Total Ontario Own-Source Revenue[1] as Per cent of Ontario GDP	11.1	11.7	11.8	12.8	13.3	13.4	13.2
Total Local Own-Source Revenue[1] as Per Cent of Ontario GDP	4.9	5.3	5.1	5.0	5.3	5.7[2]	N.A.

* Based on projections for revenue and GDP.
1 Own-Source Revenue is total revenue less all transfers from other governments.
2 1990 Local Own-Source Revenue is a preliminary estimate.
Source: Statistics Canada (GDP figures).

How Ontario Compares

It is difficult to make straight comparisons between taxes in one province and another. Not only do tax rates differ, but so do tax exemptions and some tax deductions. And of course, the level of government services may differ, too. This section provides some basic comparisons between Ontario, other provinces and the United States, within these limitations.

Ontario's personal income tax rate, now set at 53 per cent of basic federal tax, is in the mid-range in Canada. In 1991, the combined federal-provincial marginal tax rates in Ontario that—is, the rate for specific tax brackets—were third lowest among the provinces. Ontario's low-income tax reduction reduces the impact of PIT on lower-income Ontarians.

Alberta is the only province in Canada that has no retail sales tax, but sales tax rates elsewhere range as high as 12 per cent in Newfoundland. At eight per cent, Ontario's is the fifth lowest in Canada.

The overall tax cost to corporations in Ontario is not significantly out of line with that of other jurisdictions when all corporate taxes, including payroll taxes, capital taxes and employer-paid health care costs, are included in the comparison. On average, corporations don't shoulder a significantly different tax burden here then they do in other jurisdictions, including the United States. In some areas, such as payroll taxes and health care, Ontario has a distinct cost advantage over most American states.

The following table compares Ontario's tax rates with those of other provinces.

HOW ONTARIO'S RATES COMPARE TO OTHER PROVINCES[1]

	Ont.	Ont.Marginal Rates	Rank	Rest of Canada								
				Que.	B.C.	Alta.	Sask.	Man.	N.B.	N.S.	P.E.I.	Nfld.
PIT - 1991 Rates (%)												
- Statutory Rates	53 +extra		(5)	5 rates	51.5+extra	46.5 +extra	50 +extra	52+extra	60+extra	59.5+extra	58+extra	62.0
- Combined Fed/Prov rates 1991												
< $29K	26.9	(9.0)	(3)	31.0-38.0	26.6	26.3	28.4	28.7	28.1	28.0	27.7	28.4
$29K - $58K	41.1	(13.8)	(3)	46.0-47.0	40.7	39.9	42.3	42.8	42.9	42.8	42.4	43.4
Highest	49.1	(17.2)[2]	(3)	51.1	48.3	47.0	50.9	51.0	50.7	50.9	50.4	49.9
RST (%)	8		(5)	8[3]	6	-	7[3]	7	11	10	10	12
CIT - Rates (%)												
- General	15.5		(4)	6.90	15	15.5	16	17	17	16	15	17
- Manufacturing & Processing	14.5		(3)	6.9	14	15.5	15	17	17	16	15	17
- Small	10		(5)	3.75	9	6	10	10	9	10	10	10
One Litre of: (Cents of Tax)												
- Regular Unleaded	14.7		(9)	19.2[4]	9.76[5A]	9.0	10.0	10.5	12.7	12.3[5]	11.8[5]	13.7
- Diesel	14.3		(7)	19.1[4]	10.2[5A]	9.0	10.0	10.9	13.7	14.2[5]	11.8[5]	15.6
Package of 25 cigarettes - incl. RST (Dollars of Tax)	2.04		(3)	1.90	2.35	1.75	2.04	2.39	3.05	2.26	2.25	2.37
Payroll Tax (%)[6]	1.95		(2)[6]	3.75	*	*	-	2.25	-	-	-	1.5
Capital Tax - General Rate (%)	0.3		(1)[7]	0.56	-	-	0.6	0.3	-	-	-	-
Capital Tax - Banks/Trusts (%)	1.0		(1)	1.12	2.0	2.0	3.0	3.0	3.0	3.0	3.0	3.0
Case of 24 Beer - with deposit (Retail Prices) ($)	24.85		(2)	26.15	24.20	26.50	26.20	26.15	28.95	27.45	29.20	31.90

Note: Ontario's rank, 1 is lowest rate, Ontario "4" means 3 Provinces have lower rates.

1. Reflects all 1991 provincial budgets.
2. In certain circumstances, effective marginal rates for low income people can also be high because of the way in which some low income support program benefits are reduced as income rises.
3. Quebec has delayed GST harmonization to July 1, 1992. Saskatchewan has cancelled harmonization plans.
4. Quebec flat tax 14.5 cents/L for gas/diesel. 8% PST applied gas/diesel fuel prices including federal and provincial taxes. GST harmonization delayed to July 1, 1992.
5. Denotes ad valorem rate structure.
5A. Denotes ad valorem rate structure. Greater Vancouver Area add transit tax 3¢/litre.
6. Ontario has the second lowest rate of those provinces which levy a payroll tax. Manitoba exempts payrolls under $600,000 from tax and Newfoundland exempts the first $300,000 in payroll from tax. Ontario has reduced rates for small business.
7. Most provinces do not levy a general Capital Tax.

* Alberta and B.C. levy health care premiums; $744 and $624 (family) respectively.

January 1, 1992

Personal Income Tax

Ontario's Current System

Personal income tax is Ontario's largest source of revenue and in 1991-92 it will account for 33 per cent of the Province's total revenue.

With the exception of Quebec, each province participates in a personal income tax collection agreement with the federal government in which Ottawa defines income, deductions, and non-refundable credits. The federal government also collects and administers provincial income taxes for participating provinces which are thus restricted to a single rate of tax expressed as a percentage of 'basic federal tax'. Under this system, the provinces automatically adopt the federal tax brackets and rates. Ontario's tax rate is currently set at 53 per cent of basic federal tax.

Therefore, the federal government basically decides who pays the provincial tax and the progressivity or fairness of the tax. Ontario has improved the progressivity of its income tax by means of a surtax on higher-income earners and a tax reduction program which reduces or eliminates the tax paid by lower-income earners.

The following table shows Ontario's income tax rates for each of the federal tax brackets.

Federal and Ontario Marginal Personal Income Tax Rates, 1991

Taxable Income $	Basic Federal Rate %	Federal PIT Rate* %	Ontario PIT Rate** %	Combined Federal/Ontario PIT Rates %
Up to 28,784	17.0	17.85	9.01	26.86
28,785 - 57,568	26.0	27.30	13.78	41.08
Over 57,568	29.0	30.45	15.37	45.82

* Includes the general federal surtax only.
** Does not include the Ontario Tax Reduction or the Ontario surtax.

The federal government has allowed Ontario to apply a single-rate surtax. The surtax is currently set at 14 per cent of Basic Ontario Income Tax in excess of $10,000. The surtax rate was increased from 10 per cent to 14 per cent on July 1, 1991, resulting in a surtax rate of 12 per cent for 1991. The effect of the surtax in 1991 was to increase the top Ontario marginal tax rate from 15.37 per cent to 17.21 per cent. The Ontario surtax combined with the federal high-income surtax resulted in a top combined federal-Ontario tax rate of 49.11 per cent. In practical terms, the Ontario surtax becomes payable by individuals earning at least $84,000 per year.

To raise additional revenue through the personal income tax, the Province could either increase the general rate, increase the surtax, or both.

One of the principles to be looked at when considering tax increases is progressivity or fairness. Ontario applies its tax rate to the federal rate structure, so, to the extent Ottawa's tax system is progressive, an increase in Ontario's general personal income tax rate is progressive in its impact. Ontario's efforts to improve the progressivity of the tax system are further enhanced by the Ontario Tax Reduction program, which offsets the impact of the personal income tax on lower-income people, and by the surtax, which increases the level of Ontario tax applied to high-income people.

A one percentage point increase in the personal income tax general rate will yield about $275 million in a full year.

There are two ways government can increase the revenue generated by the surtax: increase the rate or reduce the level at which the surtax becomes applicable. An increase in the rate affects only those people currently paying the surtax, specifically, those earning at least $84,000 in annual income. An increase of one point would generate $20 million in Ontario in a full year.

A reduction in the level at which the surtax begins to apply would also increase revenue by including those individuals with somewhat lower incomes. For example, if the current surtax threshold was reduced to $7,000 from $10,000, individuals earning at least $65,000 would pay the surtax. This reduction in the surtax threshold would generate approximately $90 million in a full year.

Key Considerations

Ontario's statutory PIT tax rate at 53 per cent is fifth lowest among the provinces participating in the tax collection agreements. In terms of marginal tax rates, which take into account provincial surtaxes and flat taxes, income tax in Ontario is third lowest among all provinces across virtually all income brackets.

Ontario has increased its personal income tax in each of the last four years: general rate increases were applied in 1988, 1989 and 1990; and, the surtax was increased in 1988 and 1991. The 1990 rate adjustment was part of a larger package in which OHIP premiums were replaced with the Employer Health Tax (EHT).

Changes to Ontario's general personal income tax rate or to its surtax may affect personal savings and/or consumption, and make the province less attractive to mobile individuals with skills in demand.

It is also the case, however, that the personal income tax is Ontario's most progressive revenue source. The personal income tax system uses an individual's current income level, adjusted for family and other circumstances, as the measure of her or his ability to pay tax.

Retail Sales Tax

Ontario's Current System

The retail sales tax is applied to most goods and some services. Two-thirds of total RST revenue is now directly paid by consumers, with the remaining one-third directly paid by business.

For most goods and services, the RST is calculated as a specific per cent of the retail price. Ontario has four RST rates; five per cent on transient accommodation, ten per cent on alcoholic beverages sold at licensed establishments and admission prices exceeding $4, 12 per cent on alcoholic beverages sold through retail stores for home consumption and an eight per cent general rate on all other taxable goods and services. Since the introduction of the RST in 1961, the general rate has been increased three times. It was raised from seven to eight per cent in 1988.

A few goods are specifically exempt from the RST. The major items are:

- groceries
- energy used for heating, cooking and lighting
- children's clothing
- footwear costing $30 or less
- prescription drugs
- specified reading material
- production equipment and materials
- certain aids for the physically handicapped
- certain equipment and materials used by commercial farmers, fishermen and trappers
- purchases by status Indians for consumption on reserve.

The only taxable services are:

- transient accommodation
- admission prices exceeding $4
- telecommunications services (including cable and pay TV)
- labour to install, assemble, dismantle, adjust, repair or maintain goods (including any contract for the service of maintenance or warranty of goods).

Additional RST revenue can be generated by increasing the RST rates and/or by broadening the sales tax base.

Of the four sales tax rates, the general tax rate of eight per cent has the most revenue-raising potential. An increase to nine per cent would raise about $900 million on a full-year basis. Raising each of the other three RST tax rates by a percentage point would raise about $60 million per year.

The RST base can be broadened by eliminating existing exemptions or by adding new services (e.g. personal services such as hair grooming). The amount of revenue raised would vary depending on what goods and/or services are included in the sales tax base expansion.

For example, eliminating the $4 prepared food exemption and the $30 footwear threshold would raise about $150 million and $30 million respectively on an annual basis.

Key Considerations

The introduction of the federal Goods and Services Tax (GST) on January 1, 1991 means that two different sales tax systems are now in operation in Ontario. One of the biggest differences is the tax base; the GST base is much broader, including most goods and services that are exempt under Ontario's RST.

Another key difference is the taxation of business. The GST, by providing business input tax credits, has basically exempted business from federal sales tax, while Ontario's RST taxes some business inputs (e.g. office furniture and computers, trucks) and exempts others (e.g. production machinery and equipment).

The Fair Tax Commission is reviewing the difficulties inherent to the application of federal and provincial sales taxes, and the question of federal-provincial harmonization. A working group will report on this issue early this year.

Changing the RST rate is an administratively simple way to raise a large amount of revenue. However, an increase in the RST rate would have an impact on the tax burden of consumers. The change would also have an impact on the investment decisions of business, although this impact is limited by the exemption provided on production machinery and equipment.

Broadening the sales tax base could improve economic efficiency by reducing tax-induced distortions in buying habits, although changes could be complex and the cost of inputs to business could increase.

Unlike a PIT increase, an RST change is not clearly progressive in impact. Changes to Ontario's Sales Tax Credit to cushion any regressive impacts on low-income groups would partially offset the revenue increase.

Raising the RST would also change Ontario's ranking vis-a-vis other jurisdictions. For example, at nine per cent, Ontario's general RST rate would be higher than both bordering provinces and it would widen the gap between our sales tax rate and those in bordering U.S. states.

Corporations Tax

Ontario's Current System

Ontario's Corporate Income Tax (CIT) rate is 15.5 per cent for general corporations, 14.5 per cent for manufacturing and processing, farming, fishing, mining and logging income, and 10 per cent for small business. The combined federal-Ontario rates are 44.3 per cent, 38.3 per cent and 22.8 per cent respectively.

In 1988, Ontario paralleled federal corporate tax reform which broadened the corporate income tax base. Paralleling had the effect of reducing certain tax incentives, such as accelerated depreciation for manufacturing and processing machinery and equipment. As a result of federal tax reform, Ontario's effective corporate income tax rate was significantly increased.

Additional CIT revenue could be generated by broadening the tax base (for example, by scaling back incentives or restricting other deductions) or by increasing the rates.

Key Considerations

Ontario's overall corporate tax burden is not significantly out of line with competing jurisdictions when all corporate taxes are included in the comparison. For example, Ontario's higher corporate income tax rate is offset by lower payroll taxes and employer-paid health care costs.

Increasing the corporate income tax rate needs to be viewed in the context of the current state of the economy. Corporate profits as a share of Gross Domestic Product hit their lowest level since 1932 in this recession. Also, higher corporate taxes could encourage more companies to employ transfer pricing techniques (i.e. shifting profits to low-tax jurisdictions) in order to minimize taxable income in Ontario. In the 1991 Ontario Budget, the Government requested the federal government, in consultation with the provinces, to review the issue of transfer pricing.

The Government has asked the Fair Tax Commission to accelerate its consultations on a corporate minimum tax for Ontario to ensure that corporations reporting profits, but paying little or no corporate income tax, pay their fair share. Because of low corporate profits, a corporate minimum tax would not be expected to raise significant revenues in the short term. An FTC working group is expected to report back to the Government early in 1992.

Ontario levies a capital tax of 0.3 per cent on general corporations. Small businesses with paid-up taxable capital of up to $1 million and total assets and gross revenue of up to $1 million are exempt. Flat rates apply to small businesses with taxable paid-up capital of up to $2 million. Ontario's capital tax is expected to raise about $640 million in the 1991-92 fiscal year.

Ontario's capital tax rate for general corporations is in line with those of the three other provinces that levy capital taxes on general corporations. Quebec's capital tax rate of 0.56 per cent is higher than Ontario's. Saskatchewan also levies a higher rate of 0.6 per cent but the capital tax applies only to taxable paid-up capital in excess of $10 million.

Like all other provinces, Ontario imposes a capital tax on banks and loan and trust companies. Ontario's one per cent rate is the lowest in Canada. Quebec's capital tax rate of 1.12 per cent, however, is only slightly higher. In addition, the threshold at which the tax applies should be taken into account in assessing Ontario's overall capital tax competitiveness. For example, although British Columbia has a higher capital tax rate for banks and loan and trust companies, its capital tax applies only to corporations with taxable

paid-up capital in excess of $500 million and is reduced by the amount of regular corporate income tax paid.

A one-tenth of a point increase in the capital tax rate would generate $140 million in a full year.

Employer Health Tax

Ontario's Current System

The Employer Health Tax, applied to all wages paid in Ontario, came into effect January 1, 1990 to replace the previous OHIP premium system.

In 1991-92, roughly 360,000 employers will pay EHT in respect of their employees' wages and benefits.

The general EHT rate is 1.95 per cent on Ontario payrolls over $400,000. The rate is reduced to 0.98 per cent for employers having annual payrolls below $200,000, with a sliding scale for those in between.

An additional one-tenth of a point increase across all EHT rates would generate $145 million in a full year, while an increase in the top EHT rate from 1.95 per cent to 2.0 per cent for employers with payrolls over $400,000 annually, would generate $70 million.

Quebec, Manitoba and Newfoundland also impose payroll taxes. Quebec has the highest rate at 3.75 per cent and does not provide relief to small employers. Manitoba levies its payroll tax at a rate of 2.25 per cent but exempts employers having less than $600,000 of taxable payroll. Newfoundland's payroll tax rate is 1.5 per cent, but exempts the first $300,000 of taxable payroll.

The United States levies a payroll tax to help fund its medicare program for seniors. In 1991, the rate was 1.45 per cent on wages and salaries up to $125,000 per employee. This tax is part of the U.S. federal social security tax. In addition, most employers in the U.S. also provide private health care coverage to their employees. According to a report by the U.S. Chamber of Commerce, United States manufacturers in 1990 paid, on average, approximately 9.8 per cent of gross payroll to provide private health care coverage comparable to OHIP to their employees. This cost represents about $3,500 (U.S.) per insured employee.

Key Considerations

An increase in the EHT rate could force up short-term labour costs for some firms at a time when economic renewal is a critical Government priority. As well, costs to business would increase if the federal government limits the deductibility of payroll taxes.

However, the EHT ensures that all employers specifically contribute to the province's health care costs. A healthy population is a major advantage to businesses and the maintenance of

this tax source relieves both employers and employees of the need to establish private coverage.

Commodity Taxes

Ontario's Current System

Ontario's gasoline and fuel taxes are levied on a per litre basis. Certain non-conventional fuels such as natural gas, alcohol and other manufactured gases are exempt from tax. Fuels used for heating and cooking, off-road use in farming and commercial fishing, and for industrial, commercial and institutional purchases qualify for exemption or full rebate of tax.

Ontario's current tobacco tax rate is 6.5 cents per cigarette or per gram of cut tobacco. Ontario also applies the retail sales tax to the retail price of tobacco products. Ontario's overall tax on cigarettes (tobacco tax plus RST) is the third lowest of all provinces, at about 8.1 cents per cigarette.

Ontario applies three kinds of charges to alcohol: ad valorem (percentage) charges, flat levies and RST.

Additional revenue could be generated from adjustments to flat taxes on commodities (gasoline, alcohol, tobacco). However, recent tax increases and the potential for reduced consumption could affect the revenue potential.

Key Considerations

Over the last few years, gasoline and fuel tax revenues have remained fairly steady as a share of total revenue. In real terms, the price of gasoline has declined since the mid-1980s. The magnitude of past fuel tax increases should be considered in determining further adjustments to this tax. For example, over the past six years, Ontario's gasoline tax has increased by 6.4¢ per litre (or 77 per cent) while the diesel fuel tax rate has increased by 4.4¢ per litre (or 44 per cent).

Tobacco tax revenues have remained constant over the past decade, reflecting real tobacco price increases, tax increases and a decline in consumption.

In recent years, demand for alcohol has been fairly stagnant and tax revenue as a per cent of total tax revenue has gone down from 4.6 per cent in 1981-82 to an estimated 3.1 per cent in 1991-92.

Potential commodity tax changes may have implications for cross-border shopping. Increases to current levies could be perceived as increasing the incentive for cross-border shopping although a number of studies suggest that there are many other contributing factors more important than taxes.

Non-Tax Revenues

Of the Policy and Program reviews listed in the Appendix, two reviews may contribute to government revenues. The purpose of the Non-Tax Revenue Review is to look at ways to increase revenues other than by raising taxes. Some options being examined are the Gaming Services Act, Video Lotteries, Sports Lotteries and a Consumer Protection Package for sales of private vehicles.

A second review, looking at opportunities for optimizing the use of government assets, may also identify options that will contribute to government revenue.

V. CONCLUSION

This document contains more detailed information about the Province's financial situation than has ever been available before at this stage in the budget-making process.

We've introduced this more open approach because we want to encourage informed public debate about the decisions the Province is facing.

There is a complex set of needs to meet. We need to deal with unexpected weakness in the economy and in the Province's revenues. We need to prepare Ontario's workers for new types of jobs and we need to help create those jobs. We need to find ways of delivering essential public services more effectively. And we must do all these things while maintaining our commitment to fighting the recession, promoting economic renewal and preserving the quality of our lives through social justice and good public services.

How to do all these things poses an enormous challenge.

Government and society as a whole will be judged by future generations on the quality and fairness of the decisions we will make in the next few months.

Few of us feel confident that the old way of making these decisions will work. Over the next few weeks, the Government hopes all Ontarians will choose to be part of this more open decision-making process.

The Treasurer will be meeting with many groups and individuals as part of pre-budget discussions. Unfortunately, he can't meet with everyone. But we encourage you to write in your thoughts and advice.

You can initiate and take part in this debate through community groups, unions, service clubs and professional associations. You can talk to your MPP or express your views through the media or directly to the Treasurer by writing with your advice. We urge you to make your views heard.

If you wish to send a letter or make a written submission relating to the 1992 Budget, please do so by early March, addressing it to:

Floyd Laughren
Treasurer of Ontario
7th Floor, Frost Building South
7 Queen's Park Crescent
Toronto, Ontario M7A 1Y7
Fax: (416) 325-0374

In addition to this Fiscal Outlook, the Ontario Economic Outlook is available to provide the public with information for the 1992 Ontario Budget. The Economic Outlook provides an economic overview for the province through 1995, with detailed information on industries and the labour market.

Copies of these documents are available from:

Publications Ontario
880 Bay Street
Toronto, Ontario M7A 1N8
Telephone (416) 326-5300
Toll free long distance 1-800-668-9938

APPENDIX
POLICY AND PROGRAM EXPENDITURE REVIEWS

Introduction

Reviewing current program expenditures to make sure every tax dollar is being spent wisely is a key feature in the mandate of Treasury Board, a new Cabinet committee established in 1991. This process of re-evaluation will be carried out on an on-going basis to ensure Government meets the social and economic priorities it has set while at the same time addressing the problem of spending growth.

Reviews pose major challenges for the Government's policy objectives, its own operations, and those of the broader public sector, but they also provide opportunities to fine-tune policy objectives through program redesign. The review process will be guided by a number of general policy considerations including economic renewal, labour force and labour relations impact, equity objectives, impact on clients and intergovernmental relations.

The following is a list of areas that have been confirmed as subjects for review by Treasury Board:

Policy and Program Expenditure Reviews	
Ontario Drug Benefit Program	Consulting and Professional Services
Operation of Hospitals	Communication and Advertising Resources
Ontario Health Insurance Plan	Organizational Streamlining
Ontario Tax Grants for Seniors	R & D Funding/Industrial Assistance
Ontario Legal Aid Plan	Community Economic Development Programs
Social Assistance	Assistance to Agriculture
Non-Profit Housing Programs	Ontario Student Assistance Program
Ontario Courts System	Municipal Assessment Services
Optimizing the Use of Government Assets	Water & Sewer Services
Regulatory Agencies and Advisory Bodies	Non-Tax Revenue
Ontario Government Relocation Program	

Ontario Drug Benefit Program

The Ontario Drug Benefit Program pays approved drug costs for senior citizens and for persons on social assistance. The review will examine a range of options including expanding on measures announced in the 1991 Budget, developing partnerships for better drug use and longer-term measures to address equity and other concerns.

Operation of Hospitals

This review will look at the funding for operating costs of public hospitals. The review is being undertaken in line with the 1991 Supplementary Budget Paper on "Managing Health Care Funding". The Paper outlined the Government's commitment to working with health care providers to manage health care expenditures more effectively while maintaining or improving standards of care and upholding the principles of Medicare. Options under review include: examining the existing funding mechanisms for allocations; funding of special programs and services; and, system inefficiencies and opportunities for improvement.

The Ontario Health Insurance Plan

The Ontario Health Insurance Plan provides payments to physicians and other practitioners for insured health care services. Payments are also made for out-of-province medical and hospital services. The review will focus on payments made to the following categories: Other Practitioners (optometry, physiotherapy, dental, chiropractic, podiatry and osteopathy); Commercial Laboratories; and, Out-of-Province. Options under review include re-examining existing reimbursement mechanisms.

Ontario Tax Grants for Seniors

Under the Ontario Tax Grants for Seniors program, Ontario provides an annual grant of up to $600 per eligible senior household to offset property taxes paid. As well, each senior receives an annual grant of $50 to offset sales taxes paid. The program is being reviewed to ensure fairness and that government spending is being directed where it is most needed.

Ontario Legal Aid Plan

The Ontario Legal Aid Plan provides a range of legal services to all persons meeting basic financial eligibility standards. The review is examining the 'certificate side' of OLAP (which pays lawyers to take the cases of qualifying individuals) in the areas of criminal and civil law. The review is looking at options to reduce future spending increases, including: measures to limit expenditure growth; changes in delivery mechanisms; changes to the types of services covered or the eligibility criteria for those services; changes in the legal aid tariff structure; various administrative measures; and revenue-raising measures to directly support the legal aid system.

Social Assistance

Social assistance provides financial assistance to persons in need who are unable to fully support themselves. The programs under review are Family Benefits Assistance (FBA), which provides assistance mainly to single parents and persons with disabilities, and General Welfare Assistance (GWA), which provides short-term assistance to employable and temporarily unemployable persons as well those awaiting transfer to FBA.

The emphasis of the review is on decreasing the need for social assistance by reorienting the system towards employment, maximizing access for recipients to other sources of income, and reducing caseloads through better management.

Non-Profit and Co-operative Housing Programs

The objective of non-profit housing programs is to provide community-owned, good quality, long-term affordable housing for moderate and low-income individuals and families. The review will examine the current delivery of these programs for savings to net operating costs. It will also examine changes to the design of the programs to reduce capital costs and ensure the programs are continuing to meet target group needs.

Ontario Courts System

This review focuses on the delivery of justice services including the administration of the Ontario Court of Appeal, Small Claims Court, and criminal and family trial courts. The review hopes to improve efficiency and increase revenue by focusing on policy reforms, changes to administrative practices and changes to fees, fines and tariffs. Any changes will be sensitive to the issue of access to justice.

Opportunities for Optimizing the Use of Government Assets

The government holds substantial physical assets (e.g. land and buildings) and financial assets such as equity investments in crown corporations. This review is being undertaken to determine the best use for these assets to meet Government's economic, social and environmental objectives. The review is in the preliminary stages of cataloguing the assets owned by the Province. Once this has been completed, an assessment will be made of the options for using these assets including re-development, new corporate management structures, change in use, disposition or sale.

Regulatory Agencies and Advisory Bodies

Regulatory agencies control public or private sector operations, as authorized by legislation, or exercise a licence review or appeal function. Advisory bodies provide information to the government that assists in the development of policy or the ongoing delivery of programs. Both kinds of agencies depend wholly or in part on Provincial funding. This review will examine concerns over growth in the number of such agencies in the past decade and will look at options to improve cost recovery and administration.

Ontario Government Relocation Program

The Government is committed to the Relocation Program as a means of providing a more equitable distribution of government jobs across Ontario and for providing economic development to Ontario communities in need. Approximately 5,100 government jobs are to be relocated to twelve communities over a seven-year period.

The review is looking at options for managing the cash flow associated with relocation and determining cost-saving opportunities. More definitive schedules and detailed resource requirements are being developed for the seven-year time frame.

Consulting and Professional Services

The purpose of the review is to investigate current policy and practice on the use of external consultants and to examine alternatives. The review will define policy on the use of consultants to ensure more effective use of internal resources and to achieve the most cost-effective use of external consultants when appropriate.

Communications and Advertising Resources

The purpose of this review is to reduce costs. The review will identify communications costs included in program budgets, improve the provision of appropriate communications services, and consider implementation of the recommendations of previous reports on this area.

Organizational Streamlining

This review seeks to simplify government and develop more effective management approaches to delivering customer service. Opportunities will be explored to use new technologies and organizational strategies for greater efficiency, with the goal of spending a greater portion of every revenue dollar on services and programs.

R&D Funding/Industrial Development/Small Business Support

This review will encompass all Provincial programs which provide direct support to businesses in pursuit of the Government's industrial development, small business development and R&D priorities. This support may be in the form of grants, loans, loan guarantees or equity participation.

The Government wants to ensure that the existing programs meet its priorities for economic renewal and other corporate objectives, and that programs are efficiently and effectively delivered by all ministries. Programs which are not central to the Government's priorities, as well as any areas of duplication, will be identified.

Community Economic Development Programs

The Community Economic Development review is examining economic development programs that are delivered at the community level. The Province helps communities with the development of their infrastructure, facilities or related economic development programs. Several ministries, such as Municipal Affairs and Northern Development, offer financial support for community economic development initiatives related to their mandate.

The review is looking at program objectives as well as their inter-relationships. The review will also seek ways to improve both the efficiency and effectiveness of programs.

Assistance to Agriculture

Two areas of government assistance to farmers are being reviewed -- the Farm Tax Rebate program, which provides rebates of 75 per cent of property taxes paid by farmers, and the Interest Rate Assistance program, which reduces a portion of the interest costs paid by farmers.

There is a need to move agricultural assistance from short-term, ad hoc programs to long-term solutions that improve the rural economy. The review will investigate concepts such as encouraging private lending and borrowing through the use of government guarantees.

Ontario Student Assistance Program

The Ontario Student Assistance Program provides financial assistance based on need for post-secondary education students at accredited institutions. Changes could be made that would give students access to more assistance while reducing pressure on government to raise its overall program spending. Options for long-term reform will be investigated, including the repayment of loans geared to income after graduation.

Municipal Assessment Services

The Ministry of Revenue assesses all real property in Ontario for taxation by municipalities and school boards and provides a number of other related services. The Province pays for all assessment services and this review is investigating options to better manage these assessment costs.

Water and Sewer Services

This review is examining capital grants to municipalities for construction of water and sewer works. With the implementation of Provincial policies on pollution prevention, remediation, water conservation and land use planning, the Province will be facing ever-increasing demands for capital funding to finance infrastructure investments. The Government is

investigating a number of options to help meet these future demands, including full-cost pricing and a water services agency.

Non-Tax Revenue Review

Non-tax revenues include fees and licenses, fines and penalties, and sales and rentals. Ministries with the largest sources of non-tax revenues include the Attorney General, Consumer and Commercial Relations, Government Services, Natural Resources, Transportation, and Treasury and Economics (for the Ontario Hydro debt guarantee fee). For purposes of this review, non-tax revenues do not include LCBO profits, LLBO licenses and fees, vehicle registration and drivers' licenses, and royalties. The government is exploring charges for existing and new services, new sources of revenue generation and better collection of fines, fees and loans.